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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

William F. Caton
Acting Secretary
Federal Communications Commission
Room 242
1919 M Street, NW
Washington, D.C. 20554

RE: CC Docket No. 94-1
Price Cap Performance Review for Local Exchange Carriers

Dear Mr. Caton:

Enclosed herewith for filing are an original and four copies of the Comments of the Association for Local Telecommunication Services with respect to the captioned Common Carrier Bureau action. In addition, we have filed two copies of this pleading with the Tariff Division of the Common Carrier Bureau and one copy with the Commission's copy contractor, International Transcription Service ("ITS").

I am also enclosing a copy marked "receipt copy" to be stamped as received and returned to us.

If you have any questions concerning this filing, please contact the undersigned.

Respectfully submitted,

W. Theodore Pierson, Jr.

W. Theodore Pierson, Jr.
Counsel for ALTS

Enclosure

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Before the
FEDERAL COMMUNICATIONS COMMISSION
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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

In the Matter of)

Price Cap Performance Review)
for Local Exchange Carriers)

CC Docket No. 94-1

**OPENING COMMENTS OF THE ASSOCIATION FOR LOCAL
TELECOMMUNICATIONS SERVICES ON THE "TRANSITION ISSUES"
SPECIFIED IN SECTION VIII, D OF THE NPRM**

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May 9, 1994

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SUMMARY

ALTS's comments are limited to the host of issues raised by the NPRM directed toward determining whether and when the local exchange market will become sufficiently competitive to justify a further loosening of price cap regulations.

ALTS demonstrates, that by any of the traditional measures of market power, the LECs are still so dominant that the Commission must not risk any further increases in their pricing flexibility. *ALTS principal point is that it is imperative that the Commission take a fresh look at the economic paradigm that it has been using to make these judgements.* An ALTS-commissioned study by Jerry Duvall and John G. Williams found that the current model, the Structure/Conduct/Performance paradigm, fails to account for several critically important factors that limit competition. Duvall and Williams urge the Commission, instead, to turn to the "New Institutional Economics," principally developed by Professor Oliver Williamson of the University of California at Berkeley.

The New Institutional Economics focuses on transactions as the basic unit of analysis. Central to transaction cost economics is the concept of economic "property rights." These rights are examined principally from the standpoint of asset specialization ("asset specificity"). Other important factors are: differences in the degree of information available to the parties to the transaction (termed "uncertainty"); the "frequency" of the transactions; the fact that purchasers are limited in their ability to behave rationally by their knowledge of the transaction ("bounded rationality"); and the natural incentive of the LECs to engage in strategic behavior to limit the amount of competition they confront ("opportunism").

Where access and interconnection services are asset specific, as they predominantly are due to the historic monopoly in the local exchange, transaction cost economics predicts that the LECs will have the economic incentive to engage in anti-competitive activity.

- o The more specialized that the access services are, the fewer the potential sales to users; and, consequently, the greater the compulsion of the provider, on the one hand, to protect its investment by limiting the number of competitors that will eventually be able to divert sales to their own facilities, and, on the other hand, to exact a high markup on its sales.
- o The fact that access is still largely a monopoly enables the LECs to exact monopoly rents from many of their access services and to impose other profit maximizing conditions, such as long term contracts with high termination penalties.
- o The fact that the CAPs and other users of access have much less information than the LECs concerning access enhances the LECs' ability to impose onerous terms.

Transaction cost analysis, not only predicts the type of anti-competitive behavior that the LECs have manifested continually in, for instance, their massive resistance to reasonable collocation tariffs, it also suggests the solution.

The critical first step in setting the stage for effective competition in the local exchange markets is to define and describe the features, functions and costs of each type of access. The issue is how best to do this.

ALTS urges the Commission to convene immediately a negotiation among the parties interested in access and interconnection to the local exchange. The negotiation would be based upon the model successfully used in establishing interconnection rights in the long distance market, the so-called ENFIA proceedings. The Common Carrier Bureau would chair the meetings as a facilitator only, but, in order to ensure a conclusion, the Commission would make it clear that it was ready and willing to enter a prescription order

if the negotiations failed.

The Commission has a unique opportunity to adopt a model for economic analysis that accords with the actual workings of the marketplace and which holds the most promise for the creation of effective competition in the local exchange market, and to adopt a method for doing so, the first step of which is a negotiated rulemaking. ALTS stands ready to assist in this endeavor.

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**OPENING COMMENTS OF THE ASSOCIATION FOR LOCAL
TELECOMMUNICATIONS SERVICES ON THE "TRANSITION ISSUES"
SPECIFIED IN SECTION VIII, D OF THE NPRM**

The Association for Local Telecommunications Services ("ALTS") hereby submits its initial comments in response to the transition issues set forth in paragraphs 92-100, Subsection D of Section VIII, of the Notice of Proposed Rulemaking, adopted on January 19 and released on February 16, 1994, FCC 94-10 ("NPRM").

I. INTRODUCTION

ALTS will not address the specific issues on evaluation and possible changes in the price cap regulatory regime. Instead, ALTS will focus these comments on what the Commission terms *transition issues*. Section VIII,D of the NPRM states that the Commission intends to use the first Price Cap review to "develop data and information relevant to fashioning a workable plan for revising the baseline price cap model as competition develops."¹ To that end, the NPRM poses six categories of general issues and

¹ NPRM at para. 94.

dozens of specific transition issues, directed toward gathering data, establishing criteria and revising rules in anticipation of the development of a competitive market in local exchange services.

ALTS does not disagree that changes should be made in the current price cap regulatory model *when* competition has developed to the point that the LECs can no longer exercise their market dominance to discipline competitors or impose unreasonable or discriminatory rates, terms and conditions in any of the local market niches. But there cannot be any credible contention that such a degree of competition has developed or will develop within a feasible regulatory planning horizon.

As these comments urge throughout, it is imperative that regulators plan for the long term by examining and taking actions to modify the current structure of the market in order to set the stage for a competitive market down the road. On the other hand, given the dynamics of the telecommunications marketplace, propelled by constant changes in technology and entrepreneurial goals and strategies, and the propensity, ability and incentive of the incumbent Local Exchange Carriers ("LECs") to engage in strategic behavior, it is a waste of present resources (and an open invitation to exhaustive litigation) for the Commission to attempt at this time to determine when the LECs market power will be diminished to the point where significant reductions in regulation are desirable.

The LECs' contentions in the Huber rejoinder to the

ETI/Hatfield report² and elsewhere that competition from Competitive Access Providers ("CAPs") and other potential or toehold entrants currently justifies, or soon will justify, relaxed regulation *simply do not square with any known facts.*

An examination of widely-accepted measures of effective competition, such as relative market share, proves beyond any reasonable doubt that the LECs do not currently confront significant competition, however defined. Admittedly, there may be an increased *potential for competition*, as the result of such events as the expansion in the number and location of alternative access service providers, regulatory actions mandating expanded interconnection, and the possible future entry of cable television systems and micro-cell-based wireless networks. But these potential developments have done virtually nothing to diminish the current dominance of the LECs and their ability to exercise their market power. Under any plausible scenario, these possibilities will not diminish the LECs dominance sufficiently to justify lessening regulatory strictures for at least five to ten years, at best.

Even a cursory study of the basic market share indicia proves the point. If access revenues are used to calculate market shares, the CAP industry's share proves to be microscopic. The CAPs' access revenues are less than 1% of the

² Economics and Technology, Inc./Hatfield Associates, Inc, "The Enduring Local Bottleneck: Monopoly Power and the Local Exchange Carriers," (1994) ("Hatfield"); Huber, Peter W., "The Enduring Myth of the Local Bottleneck, : (1994) ("Huber Rebuttal").

\$26 billion in total LEC access revenues. Other market share indicia yield similar results. For instance, the CAP industry's capital investment is 0.6% of the LECs' plant-in-service investment. There can be no doubt that the CAPs have a minuscule share of the local exchange market, regardless of the litmus test chosen.³

A dispassionate and objective consideration of the present and near-term characteristics of the local exchange market, therefore, can lead to no other credible conclusion than the following. There is no reasonable possibility that, within the foreseeable future, "market forces generated by competition [will] effectively assure reasonable and not unreasonably discriminatory rates."⁴ It is clearly premature for the Commission to spend significant resources on such transition rules as revisions in price cap baskets, quality and reliability monitoring, and the frequency of its price cap reviews.

This does not mean, however, that the Commission should remain passive during the introduction of local exchange competition. Indeed, quite the opposite. *It is imperative that the Commission take an active and aggressive role, both (a) in policing LEC behavior to prevent strategies that impede the emergence of competition and (b) in recasting the economic*

³ Section II of these comments amplifies the facts concerning LEC market power using the traditional tests, based in part upon Hatfield.

⁴ NPRM at para. 92.

paradigm it uses to analyze the degree of competition and to establish the framework for a competitive market.

In response to the NPRM's invitation to assist the Commission in analyzing the degree of local exchange competition and implementing rules to ensure such competition occurs, ALTS commissioned a study by two long-time participants in, and observers of, the Commission's regulation of the telecommunications market. The study was undertaken by Jerry B. Duvall, a former Commission economist, and John G. Williams, a former Commission engineer. Their monograph, entitled "Guidelines for Designing Federal Regulatory Policy to Promote Competitive Local Telecommunications Services,"⁵ supports the conclusions regarding the state of local exchange competition that are derived from the traditional means of analysis, which are summarized above and detailed in Section II below. More importantly, however, the Monograph concludes that the NPRM's framework of analysis fails to account for several critically important factors that impede the possibility of a competitive telecommunications market.

The Duvall/Williams Monograph analyzes local exchange competition using the paradigm of the "New Institutional Economics", principally as developed by Professor Oliver E.

⁵ The study is attached as Exhibit A and is cited as either the "Duvall/Williams Monograph" or the "Monograph." Jerry Duvall currently is a consulting economist in private practice in Germantown, Maryland and John Williams is a Vice President of the Telecommunications Consulting Group, Inc., in Washington, D.C. Further biographical information is at page 44 of Exhibit A.

Williamson of the University of California at Berkeley. Among other matters, Duvall and Williams conclude that it is essential to properly define the "property rights"⁶ that are the cornerstone to the development of local exchange competition.

In order for the local exchange marketplace to function as a substitute for traditional regulation of the LECs, certain rights must be defined and efficiently enforceable -- including interconnection and access to local distribution networks. These rights must be open and visible to purchasers and sellers alike and furnished in a nondiscriminatory manner and at reasonable prices. Only then can access and interconnection facilitate efficient market transactions. But, such transactions cannot take place efficiently until the LEC access

⁶ The term "property rights" is not used either in the Monograph (see Duvall/Williams Monograph at 8, note 14) or in these comments in any sense other than an economic one, that is, to refer to the bundle of economic and social relations involved in voluntary transactions between two parties. These comments will use the term "rights" in the same sense that the Monograph uses the term property rights, in order to avoid any implication that the term is used to reference any legal consequences that may flow from the constitutional prohibition against "taking" of property without just compensation. This issue is currently the subject of the appeal of the Commission's special access expanded interconnection order and involves a totally different use of the term "property rights." *Expanded Interconnection with Local Telephone Company Facilities*, 7 FCC Rcd 7369 (1992), appeal pending sub nom. *Bell Atlantic Corp. v. FCC*, No. 92-1619 (D.C. Cir., filed Nov. 25, 1992). It is important for the Commission to recognize that over one hundred years of regulatory law have firmly established the ability and duty of regulatory commissions to attenuate the economic property rights of common carriers by requiring them to offer reasonable and nondiscriminatory access to their facilities and services. *Munn v. Illinois*, 94 U.S. 113 (1976); *Lincoln Tel. & Tel. v. FCC*, 659 F.2d 1092, 1103-1106 (D.C. Cir. 1981); *Bell Telephone Co. of Pennsylvania v. FCC*, 503 F.2d 1250, 1268-73 (3rd Cir. 1974); cert. denied, 422 U.S. 1026 (1975).

rights are sufficiently well defined that all parties to those transactions understand what those rights are and can correctly gauge the appropriate prices to be exacted.

The *essential first step* then on the pathway to a competitive marketplace is to *define the scope of the rights* attendant to the provision of services by the LECs to the CAPs and other customers. The *second step* is to take regulatory actions that will minimize the cost of transferring those rights.

The lower the transaction costs, the more likely that efficient market exchanges, which will encourage the emergence of full and effective competition, will occur. That is, if the transaction costs are sufficiently low, the nascent competitors will be motivated to purchase access and will be able to compete effectively; and the LECs generally will be motivated to engage in efficient market transactions with other firms in the market. (And, if the rights are sufficiently well-defined, LEC anti-competitive behavior will be more detectable and correctable, with less impact upon the marketplace and upon Commission resources.)

The Duvall/Williams Monograph identifies the factors that have the greatest impact upon the cost of the LECs' transactions with potential competitors and demonstrates how these factors permit, and, in many cases, drive, the LECs to price strategically so as to disadvantage their competitors and to retain their market power. The most significant factor

affecting transaction costs is the degree to which the LEC services provided to CAPs and other users require the use of specialized assets. The greater the degree of specialization, or *asset specificity* (i.e., specialization of an asset which lowers its value in alternative uses), the greater the incentive of the LEC to engage in anti-competitive behavior.⁷

The present elements of access and interconnection to local exchanges are largely specialized or asset specific.⁸ This occurred for two reasons, both explainable by transaction cost economics. First, because the national telephone system developed as an integrated monopoly with no external buyers, there was no economic reason to design a system that would be less specialized, more fungible, and more accessible to outsiders. The local telephone companies were assured of sales within a very broad range of price elasticity. The assurance of being able to recoup investments in specialized assets was reenforced by the well-known perverse incentives of rate-base, rate-of-return regulation, which rewarded excessive investment.⁹ Second, asset specificity could be a very powerful strategic weapon. The more asset specific access could be made, the

⁷ Duvall/Williams Monograph at 31-32.

⁸ See, generally, *Expanded Interconnection Order*, *supra* note 6; *Expanded Interconnection With Local Telephone Company Facilities*, Second Report and Order, 7 FCC Record 7740 (1993) (Switched transport interconnection).

⁹ Averch, H., and L. Johnson, 1962, "Behavior of the Firm Under Regulatory Constraint," *American Economic Review*, Vol. 52, No. 5, pp. 1053-1069.

greater incentive and the ability of the LECs to engage in strategic behavior to create entry barriers. The LECs recognized that the more expensive and difficult to understand and use access was, the more difficult it would be for competition to thrive.¹⁰ Their terms, prices and stalling tactics in the special and switched access realms are proof positive.

The task of the regulator is to take actions to reduce transaction cost barriers to competition. Such actions should include: (1) insisting upon the use of non-specialized assets in the provision of access, wherever economically feasible (by, for instance, requiring unbundling);¹¹ (2) increasing the amount of information available to the LECs and their buyers; and (3) increasing the frequency of the purchase of access services (by fostering the emergence of a multitude of buyers). The LECs often define, provision, and package network functionality in ways that limit the fungibility of local exchange assets across

¹⁰ As the Duvall/Williams Monograph points out, there are valid transaction cost minimizing reasons why LECs might be hesitant to provide service to competitors, in addition to strategic reasons. This is all the more reason for the Commission to foster negotiations among the industry participants as suggested below.

¹¹ One of the principal ways in which the LECs create asset specificity in access and interconnection services is to bundle together discrete elements that could be furnished separately on a menu basis. A classic example is the local loop. Many LECs still insist that, in addition to call completion over the local loop, CAPS and other users must also purchase ports, switching, etc.

service and user categories and applications.¹² So long as this asset specialization practice continues unabated, the ability of competitors to gain functional, useful, economic and timely access to LEC networks will be greatly circumscribed and the development of competition substantially impaired.

A necessary precondition to achieving these goals is to identify the rights at issue. As the Duvall/Williams Monograph points out, this task can be substantially more complicated than the task of defining the rights necessary to the provision of a competitive terminal equipment market or a competitive long distance market.¹³ It is not a task that is likely to be accomplished, within an acceptable time frame and with the correct result, through a continuation of the paper wars that have characterized the special and switched access expanded

¹² The subtleties and intricacies of the impact of asset specificity on the efficiency of the local exchange market are explored in the Duvall/Williams Monograph, principally in Section 2.2.2.2.

¹³ The likelihood that in many cases it might take longer and require a greater effort to define access and interconnection rights within the local exchange than it took to define such rights between the local exchange boundaries and CPE and interexchange carriers (Duvall Williams Monograph at 1-2) is not a reason for regulators to stay their efforts to open up local markets. Quite the contrary, the differences make it all the more imperative for state and federal regulators (for whom this effort is a statutory mandate) to commence and complete the process of defining and pricing the LECs obligations to afford access as quickly as possible. Nor is the fact some forms of access cannot be defined as readily as others a reason to forestall the entry of competitors. As regulatory history has shown time and time again, the entry of competitors assists the regulators in determining the rights and obligations necessary to achieve a truly competitive market.

interconnection proceedings to date. A different approach must be tried.

ALTS urges the Commission to adopt the solution that was successfully used to devise the terms and conditions of access by the competing long distance carriers¹⁴ -- *a negotiation to develop a consensus on the terms and conditions of access elements among the industry participants, held under the auspices of the Commission staff.* ALTS is confident that an off-line, shirt-sleeves negotiation, if properly structured and incented, will produce a workable set of definitions of the elements of access necessary for the development of a competitive local exchange market -- in much less time and at a much smaller expenditure of Commission and industry resources. In order to be successful, the negotiation must be chaired by the Common Carrier Bureau staff, and the Commission must make it clear that it will prescribe the terms, conditions and prices of access if the negotiation has not reached a consensus within a reasonable time frame. ALTS and its members stand ready to participate fully in such an endeavor.

II. THE CURRENT AND NEAR-TERM STATE OF COMPETITION FOR LOCAL SERVICES IS PLAINLY INSUFFICIENT TO SUPPORT REDUCED OR STREAMLINED REGULATION OF PRICE CAP LECS.

When the local exchange market eventually becomes sufficiently competitive, ALTS agrees that the Commission could

¹⁴ The process in the long distance market is commonly called the ENFIA negotiations. See note 75 *infra*.

appropriately consider transition rules for phasing out LEC price cap regulation. However, as demonstrated in ETI/Hatfield, and discussed further below, the extent of competition in the local exchange market today and over the next decade is so minuscule that any Commission inquiry now into easing LEC price cap regulation would simply be a waste of public and private resources.

Rather than trying to speculate about when the ultimate demise of LEC regulation might become appropriate, the Commission and its state counterparts should concentrate their resources on removing the significant barriers that still remain. The Commission can help accomplish this by fostering the creation of efficient markets for those services and facilities which are essential to viable competitive entry and open network access, and thereby also facilitate the ultimate development of the "network of networks." By establishing a framework which permits essential facilities to be exchanged in the marketplace on an open and non-discriminatory basis with a minimum of transaction cost to the participants, the Commission could expedite the arrival of meaningful local competition that would truly merit a reconsideration of LEC price cap regulation.

A. The Current State of Competition for Local Exchange Service and Interstate Access Is Minimal, Judged by Widely Accepted Standards.

The LECs claim they currently face, or will soon face, competition from a proliferation of CAPS (and other competitors)

in their respective regions.¹⁵ But the most widely-accepted measures of competition, principally market share and growth, demonstrate the LECs do not yet face any level of appreciable competition -- a level far below the degree of competition that would be needed to justify any removal of LEC price caps.

Utilizing access revenues to calculate market shares clearly demonstrates the minute share of the market held by CAPS. LEC annual gross access revenues in 1992 totaled \$26 billion. In sharp contrast, CAP revenues were only \$250 million in 1993, less than one percent of the LECs' total access revenue.¹⁶

The insignificant presence of the CAP industry in comparison to the total access industry is equally evident from other indicia. For instance, the CAP industry's total capital investment is only 0.6% of the LECs' total plant in service.¹⁷ And in 1993, all of the CAPS combined had only 1200 network employees among 30 companies, and served only 4000 buildings

¹⁵ See, e.g., *NYNEX Transition Plan to Preserve Universal Service*, DA 93-1537, NYNEX Petition for Waiver, filed December 15, 1993, and LECs' Comments, filed January 31, 1994; *In the Matter of Transport Rate Structure and Pricing*, CC Docket No. 9-213, Bell Atlantic Petition for Reconsideration, filed December 21, 1992 at 2-4, and Pacific Bell Petition for Reconsideration, filed December 21, 1991, at 10. LECs argue that they face competition so intense that pricing flexibility is required.

¹⁶ Hatfield at 31, note 48, citing *FCC Statistics of Communications Common Carriers*, 1992; Sazegari, Steve A., "The Shape of Competition in the Local Loop," *Business Communications Review*, March, 1992, at 49.

¹⁷ Hatfield at 2-3, Figures 1.1 and 1.2.

throughout the entire country.¹⁸

Using any reasonable measure of market share, it is thus apparent that the CAP industry is nowhere near a significant competitor for the LECs, let alone so robust a source of competition that the LECs should be further deregulated. Although definitions of a competitive marketplace vary, no economist would suggest that a one or two percent industry market share constitutes sufficient evidence of a competitive marketplace. Given that substantial market share is typically considered indicative, though not always dispositive, of market power,¹⁹ and has been relied upon by the Commission to determine whether a firm faces substantial competition,²⁰ the CAPs'

¹⁸ "Local Telecommunications Competition . . . The ALT Report," Connecticut Research 1993, at I-2 and II-4. [Hereinafter "The ALT Report."].

¹⁹ *E.g., United States v. Grinnell Corp.*, 384 U.S.563, 571 (1966); *Broadway Delivery Corp. v. United States Parcel Service of America, Inc.*, 651 F.2d 122, 129 (1981) ("a market share of 50% is rarely evidence of market power, a share of between 50% and 70% can occasionally show market power, and a share above 70% is usually strong evidence of monopoly power."); U.S. DEP'T OF JUSTICE MERGER GUIDELINES - 1992, 4 Trade Reg. Rptr. (CCH) ¶ 13,104 at 20,573-5 ("Market concentration is a function of the number of firms in a market and their respective market shares.") See also 20,573-6 ("However, in some situations, market share and market concentration data may either understate or overstate the likely future competitive significance of a firm or firms in the market . . .") ("Merger Guidelines").

²⁰ *Rates for Competitive Common Carrier Services, Fourth Report and Order*, 95 FCC 2d 554 (1983), *rev'd in part sub nom. AT&T v. FCC*, 978 F.2d 727 (D.C. Cir. 1992) (in applying an antitrust framework to determine whether various categories of interexchange carriers were nondominant, the Commission analyzed relevant markets and found that because the market shares of the carriers at issue were small, the carriers were nondominant); *Competition in the Interstate Interexchange Marketplace, Report and Order*, 6 FCC Rcd 5880(1991) (The Commission determined that AT&T was nondominant in

diminutive market share is clearly inadequate to support any finding of effective local competition for the LECs.

It is equally apparent that this absence of local exchange competition will be not be alleviated anytime soon. For instance, between 1992 and 1993, the CAP industry had an annual growth rate for access revenues of 25%.²¹ At this rate it would be four years before the CAP industry's access revenues doubled in size to 2% of the LECs', and, ignoring market growth and other sources of possible competition, LEC market share will not erode to the 50% level until 2012.

Furthermore, this rate of growth may prove to be overstated. The CAP industry's growth in 1993 fell somewhat below these projections due in major part to LEC-initiated delays and other obstructions in converting the Commission's expanded

most of its high volume business services. Although not relying solely upon a market share approach, the Commission stated that it relied in part on " . . . unrefuted evidence that AT&T's market share is substantially lower in business services than it is in other markets." *Id.* at 5887. Specifically, the Commission noted that "AT&T's market share in business services appears to be about fifty percent, a level that is not incompatible with a highly competitive market." *Id.* at 5890. The Commission concluded that the share was not high enough to make AT&T a dominant firm, although its share of the total interexchange market, about 65%, was considered adequate to render AT&T dominant at the time. *Id.* at 5890 n.92.); *International Competitive Carrier Policies, Report and Order*, 102 FCC 2d 812 (1985) (The Commission's decision to reduce regulations was based on antitrust analysis which demonstrated that the carriers commanded low market shares and there were low barriers to entry.)

²¹ The ALT Report at I-2.

interconnection orders into reality.²² (The ALT Report at I-2.) Moreover, as the CAP industry matures it is unlikely to sustain current rates of growth. It is well-recognized that the initial growth rates of new entrants slows over time. But even if the CAP industry growth rate remains the same, the CAP industry cannot conceivably achieve a market share sufficient to justify further deregulation of the LECs until well into the twenty-first century.

Turning from the future to the past, it is apparent from the Commission's own experience that no telecommunications market has ever become competitive with the lightning-like speed which the LECs are now claiming for the emergence of competition in the local exchange market. The most applicable historical comparison -- the emergence of competition in the long distance market -- clearly demonstrates that a significant amount of time is required in order to achieve viable competition in telecommunications markets.

By 1984 AT&T had been ordered to divest its Bell operating

²² Expected CAP revenue increases from the Commission's mandated collocation policies have been slower than anticipated because tariff filings for special and switched access interconnection have been found to raise issues of unlawfulness and are the subject of on-going disputes and FCC investigation. *Expanded Interconnection With Local Telephone Company Facilities*, Report and Order and Notice of Proposed Rulemaking, 7 FCC Rcd 7369 (1992), recon., 8 FCC Rcd 127 (1992); *pets. for recon. pending, appeal pending sub nom. Bell Atlantic Corp. v. FCC*, No. 92-1619 (D.C. Cir., filed Nov. 25, 1992); *Expanded Interconnection With Local Telephone Company Facilities*, Second Report and Order and Third Notice of Proposed Rulemaking, 7 FCC Rcd 7740 (1993). See also, *Local Exchange Carriers' Rates, Terms and Conditions for Expanded Interconnection for Special Access*, 8 FCC Rcd 8344 (1993) ("Special Access Interim Prescription Order").

companies, and the BOCs had been ordered to provide equal access to the local exchange for all interexchange carriers. At that time, AT&T's share of the interstate switched access market was about 80%, and its share of the highest quality of access to the local exchange was 98%.²³ During the next several years, AT&T's share in both markets gradually declined as equal access was implemented. As a result, in 1990 its market share had diminished to approximately 65% in both categories.²⁴

It was not until this point in time, in 1990, after AT&T's share had been reduced to less than two thirds of the total long distance market and its competitors had been active in that market for two decades, that the Commission proposed to make significant changes to its regulation of AT&T. Even then, the Commission only extended streamlined regulatory treatment to a limited set of AT&T's business services -- those in which AT&T commanded about 50% of the market. The Commission found that 50% was "a level that is not incompatible with a highly competitive market."²⁵

The Commission's NPRM in the present proceeding suggests an intent to proceed in the local exchange market in a manner similar to the path it followed in the long distance market. If

²³ See "Long Distance Market Shares, Third Quarter 1992," Industry Analysis Division of the Federal Communications Commission, January 8, 1993.

²⁴ *Id.*

²⁵ *Competition In the Interstate Market, supra*, note 20 at 5890.

so, the Commission should bear in mind the lessons learned in the long distance market. First, the Commission concluded that the dominant interexchange carrier did not warrant significantly increased pricing flexibility until it had lost considerable market share. Second, despite claims by AT&T that consumers and itself would be irreparably harmed by postponing pricing flexibility, no such harm ever occurred. Third, the Commission and consumers were rewarded by the Commission's patience and its resistance to the dominant carrier's unfounded claims with the advent of a vigorous long distance industry in which prices have plunged by almost fifty percent and in which there are hundreds of competitors and an increasingly diverse menu of rates and services.²⁶

The long road to long distance competition is acknowledged by the LECs' chosen expert, Peter Huber. Huber concludes that competition in the long distance market commenced in 1978 with the D.C. Circuit's *Execunet II* case.²⁷ Only after that case, Huber notes, did the Commission grant other interexchange carriers the right to interconnect with Bell exchanges. Four years later, the divestiture decree affirmed that right and

²⁶ In addition to the fact it took decades for interexchange competition to become robust, it is of critical importance that the Commission did not grant relief until the dominant carrier's share in certain competitive markets reached 50%. As noted *supra*, assuming a 25% annual growth rate for CAPS and ignoring market growth and other possible competition, LEC market share will not erode to this level until the year 2012.

²⁷ *MCI Telecommunications Corp. v. FCC*, 580 F.2d 590 (D.C. Cir. 1978), cert. denied, 439 U.S. 980 (1978).